

Rockville Summit II
City Services and Budget Report

Submitted by

City Services and Budget Work Group

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Introduction

The City Services and Budget Work Group is pleased to present our report and hope that our recommendations can be incorporated into the way the City does business in the future. We want to thank the City staff for all of their support and expertise. Without their help, it would not have been possible for the work group to complete this report. We would also like to thank our elected leaders who made themselves available to provide much needed information and perspective on the many issues the City faces.

This report represents the consensus of the work group and there was no substantial disagreement among the members. The members met twice a month from June to October 2012, in addition to working in subgroups.

The work group was tasked with examining the City's balancing act of providing high quality services and generating the revenues necessary to pay for these services. The work group was asked to address the questions listed below in our report. In some cases it would be difficult to answer specifically without further information. We have made several recommendations that provide information for the City leaders to make more informed decisions in the future.

The questions that were asked were as follows:

General Questions

- *What are recommended City goals with respect to city services and the budget?*
- *Define Rockville's strengths and limitation with respect to these goals.*
- *How does the City fit into the region on this issue?*
- *What do we need from the county, state, and federal governments and how do we propose working with each jurisdiction?*

Group-Specific Questions

- *How does Rockville balance the desire for strong city services, a thriving economy, and reasonable tax rates?*
- *What are our assumptions for future revenues to cover the necessary and desired city services?*
- *Do the assumptions for future revenues include the consideration of adjustments with respect to the tax base and revenues generated?*

It was the consensus of the work group that raising taxes and fees should be considered only after making careful value judgments on expenditures, examining costs and methods, and exploring the potential of enhancing the tax base. Our recommendations reflect this view.

The work group was very concerned about flat or declining revenues and ever increasing costs. In particular there is concern about the future indebtedness of unfunded pension liabilities and funding for future Capital Improvement Projects (CIPs). A large part of our focus was on these items.

The work group avoided making value judgments on most programs or City activities. One of our goals was to provide durable recommendations that would survive the change of elected officials and governing philosophies.

Thank you for your consideration.

Section I. Revenue Generation

For Rockville to be vital and vibrant, it must have the synergy of strong residential and business communities. These communities are inextricably linked and the recommendations contained herein are aimed at providing the City leadership the information they need to make difficult decisions regarding the balance of the communities and Rockville's long term financial health.

All revenues come to the City primarily from taxes, fees, and transfers from other governments. Major revenue components have been flat or declining, with no reliable upturn in the foreseeable future and significant downward risk from potential decisions that Congress will make about the budget of the federal government. The cost of running the City continues to increase and there is no desire or movement to diminish services. The fiscal year (FY) 2013 budget projects that the property tax base will decline as a result of property reassessments and the City will need to decide if property tax rates will need to be increased sufficiently to keep the dollar levels of property taxes paid at the FY 2013 level. Beyond this decision, the City has only three avenues to raise the revenue necessary to maintain services as desired. The City could choose these alternatives in combination or independently.

1. Raise taxes and fees on current Rockville residents/businesses.
2. Generate new revenue from economic development.
3. Find ways to provide the same or similar services at less cost.

Raising taxes and fees to existing residents and businesses should be considered only after other plans of action have been thoroughly explored.

Maintaining and attracting new businesses to Rockville is a highly competitive enterprise. Many jurisdictions have budgets for this work that far outstrip that of Rockville. Commercial properties occupy 16 percent of City land and pay 40 percent of the property taxes. A strong commercial tax base significantly lessens the tax burden of the residents.

Revenue Generation Recommendations

The current and future City leaders and planning commissioners will have varying opinions about the proper balance of business and residential development. The goal of this work group is to make it possible for City leaders to have as much information as possible when making decisions that have an economic impact on the City. To that end, we make the following recommendations:

- An educational initiative should be established to highlight for all stakeholders how property is assessed and the economic impact (costs and tax base enhancements) of various property types on the City's budget.

- A component of all long term land use planning should include the estimated economic impact to the City in terms of revenue enhancements and expenditure impacts on the operating budget.
- Estimated long term economic impacts should be component of long term budget outlook discussions.
- All pertinent staff reports regarding land use to the Planning Commission and Mayor and Council should include estimated economic impact.
- Economic impact should be part of the discussion at Planning Commission meetings when considering any proposed development.
- The City should perform a competitive analysis between Rockville, Gaithersburg, and Montgomery County that would include zoning, entitlement costs, and process to understand Rockville's competitive advantages or disadvantages in creating potential redevelopment or annexation opportunities.
- Using the principles outlined above, the City should consider approaching owners of the potential annexation properties about annexing into the City.

To generate new revenue and maintain the synergy between the residential and business communities, it is imperative that the City of Rockville support and promote continued business and job growth in the City. We recommend:

- Continued investment in Rockville Economic Development, Inc. (REDI) to serve as the business growth and economic development agency for the City of Rockville.
- The adoption of an "Incentives Policy" outlining assistance that could be made available to companies expanding and/or locating in the City of Rockville (to include both financial and non-financial incentives, i.e. streamlined permitting, etc.).
- Establishing an Economic Development Fund that could be used to match State and County financial incentive offers to new and expanding businesses bringing increased jobs and tax revenues to the City.
- Reviewing and streamlining City processes – quicker permitting saves businesses money and would serve as an incentive in attracting economic development.

Section II: Pension Funding

The financial status of the City's defined benefit (DB) plan has serious long-term budget implications and current budget impacts. We are encouraged by the Mayor and Council's recent focus on the issue and offer several suggestions for their consideration.

Current Status of DB Plan

According to the 2013 Actuarial Valuation Report from the Hay Group, the DB plan has a 71.8 percent funded ratio.¹ In layman's terms, this means the plan's assets are 28 percent less than is needed to fully pay benefits earned by current and retired employees. By comparison, the funded ratio was 95.5 percent just four years ago, before the 2008 market crash. The current dollar shortfall is almost \$25 million.² To put this in perspective, if the City had to fund the entire shortfall this year, it would take about 38 percent of the General Fund budget for FY 2013.

Obviously, the City cannot afford to eliminate the shortfall in a single year. Instead, taxpayers will be burdened with this cost for years. The City's policy is to make additional payments to the DB plan over the next 20 years to eliminate the shortfall. This makes the refunding more manageable, but as shown in the table below, it amounts to a \$1.8 million hit on the 2013 budget, which is \$300,000 more than the regular amount the City pays to fund benefits earned by employees in the current year.³

FY 2012 General Fund DB Plan Contribution

City payment for benefits earned in current year	\$1,503,923
Additional payment to fund shortfall	\$1,802,902
Total budget cost	\$3,306,825

Source: City of Rockville Pension Plan year beginning April 1, 2011 and ending March 31, 2012, Hay Group, page 3.

¹ Page 1-6 of the FY 2013 Adopted Budget.

http://www.rockvillemd.gov/budget/fy2013/adopted/FY2013_Section1.pdf

² Page 1-6 of the FY 2013 Adopted Budget.

http://www.rockvillemd.gov/budget/fy2013/adopted/FY2013_Section1.pdf

³ Note that these estimates are based on the assumption that plan assets would earn 7.75% annually. After the Hay Group calculated these amounts, the City reduced the assumed annual earnings rate by 0.25% to 7.50%, which should be expected to increase the required annual payment to fund the shortfall.

<http://www.rockvillemd.gov/government/commissions/retirement/reports/PensionFund033112.pdf>

Recommendations

The City clearly wants to ensure that the DB plan has sufficient assets to fully fund pensions earned by City employees. The City has regularly funded the amount calculated by the actuaries needed to fund benefits earned during the current year. Still, the 2008 market crash left a large hole in the fund, and the annual cost to taxpayers has increased dramatically, suggesting the need to take a hard look at the plan. We offer the following four recommendations for consideration by Mayor and Council.

1. Contract for a comparative study of the total compensation package for City employees. We commend the Mayor and Council for focusing on the cost of the City's DB pension plan, but we suggest taking a broader perspective. A rich pension plan may be offset by lower current compensation, and vice versa. We think it would be useful to know how the City's full compensation package – wages and all benefits – compares to the full compensation package for employees of other local governments in the region. Pension changes should be reviewed for to-be-hired future employees, while 'grand-fathering' current merit staff. We suggest that the study also include a comparison with private sector employees, to assess whether the City's compensation package is in line with the private market.
2. Assess a Supplemental Employee Contribution to help eliminate the pension plan shortfall. The City's DB plan includes a provision allowing the City to impose a Supplemental Employee Contribution (SEC) on all employees whenever the City's contribution exceeds 6.5 percent of the earnings of employees. The SEC cannot exceed 50 percent of the excess of the City's contribution over 6.5 percent of employees' earnings. Because of the large shortfall in the pension fund, the City's 2013 contribution is 11.53 percent.⁴ Even with the substantial supplemental contributions planned to be made by the City, the City's annual contribution would exceed 8 percent of member compensation in FY 2018.⁵ We understand that the City has never exercised the SEC option, and the reluctance to do so is understandable. However, the provision was included in the plan most likely to address a shortfall stemming from extraordinary events, like the current one. The current shortfall results largely from losses sustained when financial markets crashed in 2008/2009, not from the failure of the City to make required payments. Taxpayers are currently bearing the full risk of this market failure. We believe it would be fair and reasonable for the City to require employees to share some of this risk by increasing their contributions until the total annual required payment falls below the 6.5 percent trigger.
3. Provide an independent fiduciary review of the plan at least once every three years to assure the following:
 - That investments are managed in accordance within the constraints of an investment policy statement.
 - That the roles and responsibilities of all parties to the plan are defined, documented, and acknowledged.

⁴ City of Rockville Pension Plan year beginning April 1, 2011 and ending March 31, 2012, Hay Group, page 1.

⁵ City of Rockville Pension Plan year beginning April 1, 2011 and ending March 31, 2012, Hay Group, page 8.

- That all fiduciaries and parties in interest (actuaries, investment consultants, brokers, accountants, committee members) are not involved in self-dealing.
- That both an investment time horizon and risk level has been identified.
- That an expected, modeled return to meet the investment objectives has been identified and that asset classes are consistent with the risk, return, and time horizon.
- That alternative investment providers are compared for fees and with applicable benchmarking as determined by the investment policy statement. Comparisons to the incumbent should be performed using appropriate indexes, peer group, or other measures for consistency.

Section III: Capital Improvement Projects and Infrastructure

Street Repaving

Until a few years ago, city streets were repaved every 10 years. Now, city streets are repaved every 12 years. Although the longer duration of the repaving cycle decreases costs in the short term, the longer cycle is likely to shorten the lifespan of roads. If the City extends the repaving cycle any longer, the extended usage could cause more extensive damage to the roads, thereby increasing repair costs in the long term.

- **Recommendation:** In order to prevent unnecessary degradation of roads and higher repairs costs in the future, the repaving cycle for city roads should not be allowed to extend beyond the current 12 year schedule and should be reprioritized for funding. The City should periodically review and adjust this schedule based on municipal best practices and the City's experience of the extended duration.

Replacement of Water and Sewer Pipes

Rockville provides drinking water and wastewater services to nearly three-quarters of the City's population. Much of the infrastructure of water and sewer pipes is aging. Over time, the interior of water pipes narrow due to tuberculation, which restricts water flow and degrades water quality. Aging sewer pipes are prone to developing blockages or leaks.

Many pipes in the City are in need of repair or replacement. In recent years, the City replaced the highest priority water pipes, and plans to replace an average of 1.7 miles of pipe per year in the future. This is equivalent to a 100 year replacement cycle. Sewer pipes are inspected at least once every 10 years for needed remediation. In the future, the City plans on relining 1.3 miles of sewer pipe per year.

- **Recommendation:** The current replacement rate of 1 percent of water pipes per year is insufficient to keep up with the degradation of the existing aging infrastructure. Rockville needs a functioning infrastructure to support its growing economy and population. A higher priority should be placed on adequately funding these programs for the actual expected future replacement costs.

Unfunded CIPs

As part of the annual budgeting process, the City identifies worthy infrastructure and construction projects. Examples of Capital Improvement Projects (CIPs) include repaving of roads, replacement of streetlights and playgrounds, renovation of city buildings, and construction of stormwater management systems. In fiscal year 2013, the City approved \$28 million in new funding for CIPs. An additional \$45.6 million in CIPs were identified by city staff but not funded in the budget. Past budgets have also included tens of millions of dollars in unfunded

CIPs. Some unfunded projects, like renovation of the Rockcrest Center, have been pushed back for years.

Over the next decade, the City will be required to invest in its infrastructure in order to maintain the quality of life residents and property owners expect. Several of these projects, like replacement of the two City-owned bridges over I-270, will likely cost millions of dollars and may be difficult to predict in advance. The City does not prefund CIPs, and to pay for them the City will need to take on new debt. The City currently has a AAA bond rating, in part because the City's tax supported debt is only 0.6 percent of the assessed value of taxable property within the City. According to City financial policy, Rockville can increase its borrowing ratio up to 1.0 percent of the value of assessed taxable property.

- **Recommendation:** The current rate of funding for CIPs is not sufficient to address Rockville's needs. In order for the City to adequately maintain its infrastructure, Rockville should consider issuing new debt in a fiscally responsible manner while interest rates are low to pay for priority CIPs.

Section IV: City Services

The City of Rockville provides an exceptional level of services to its residents. Core services include the police, recreation, water and sewer, refuse and recycling collection, leaf collection, maintenance of bridges and roads, social services, and senior services. City residents have a high level of expectation for city services. The sustainability of the current levels of city services is a challenge. The work group does not recommend that any of these core services be increased; however, the cost for the City to provide these services may increase as Rockville's population grows, as is currently projected.

City services should be reviewed on a regular basis to determine:

- If the services are still serving the needs of the population;
- If the services are cost effective;
- If the services could be more efficiently performed by another entity; and
- What fees, fines, or surcharges should be considered to make a service as revenue neutral as possible.

The City should also look at what other neighboring jurisdictions provide in terms of types of services and frequency of services. The City should investigate if the frequency of some services (for example, leaf collection or the maintenance of flowers and plants in the medians and parks) could be reduced without an adverse effect to residents and still result in significant savings to the City. Several years ago the City successfully reduced the collection of trash from twice a week to once a week. There may be similar savings if the frequency of other services were likewise reduced.

There are a number of other services the City provides that may be reduced, provided electronically, or cancelled. For example, printing costs for various City brochures and publications printed can be significantly reduced if these documents are available online. The City should look into what savings may be realized by consolidating purchases or having uniformity in office equipment across departments. The City should also reconsider the cost effectiveness of some small scale services that are not widely known or utilized by residents, such as providing resources to deal with unwanted wildlife.

Eliminating wasteful spending is an important part of the annual budget process. Both City staff and residents play vital roles to suggest options for eliminating wasteful spending. Residents, as the recipients of City services, are ideally positioned to identify wasteful or unnecessary spending. Residents already send suggestions to the Mayor and Council or to City staff, but this depends on their own initiative and results in sporadic suggestions. We suggest creating a highly publicized and organized "Save Award" process aimed at City staff as well as residents to solicit, review, and rank suggestions. The City would announce the opening of the Save Award process and collect suggestions via an email address for a period of time, perhaps for one month. A task force consisting of residents and City staff would review the submissions and select the top ideas to save the City money. City staff and resident category award winners would be announced at a regular session of Mayor and Council. Residents who nominated a winning idea would receive a small monetary award, for example, a dinner for two at a Town Center restaurant. Individual City staff or work units who identified the best ideas and saved the most funds would be

rewarded by reinvesting the savings back to their work unit for additional services, or avoid some targeted reductions in their unit. At the end of the first Save Award process, the City would evaluate the effort and decide if it would make sense to fund another Save Award in the following year.

The City sponsors several major events each year including but not limited to Hometown Holidays, Memorial Day Parade, and the Fourth of July celebration. It is recommended that events be examined with a goal of having the costs for these events minimized or in the aggregate having these events be revenue neutral.

The City leases space to non-profit organizations. It is recommended that City leases be structured so that the City's costs (maintenance, utilities, insurance, etc. at a minimum) are recouped from the lessee. It is also recommended that any agreement to subsidize an outside entity, in any fashion, provide for a periodic review. This review would be to determine the following:

- If the arrangement is still of value to the City;
- If the entity is in compliance with the terms of the lease agreement;
- To determine if the subsidy meets the test for the expenditure of taxpayer money;
- To change the structure of the relationship as necessary to reflect the current needs of the City; and
- To provide future elected officials the flexibility to guide the City into the future in a manner they deem appropriate.

It is also recommended that no arrangement be entered into without first establishing the metrics to measure the expected outcomes. These metrics should also be subject to periodic change as circumstances warrant.

Section V: Impact of Budget on Taxpayers

The City does not currently track the net impact of its annual budget on taxpayers. Conversely, Montgomery County summarizes the average annual amount paid by residents in taxes and fees in a table in its annual budget documents. Rockville should similarly summarize in its budget the average amount paid by each city household to the city government for property tax, stormwater management fee, and water, sewer, and refuse charges each year. Such a summary would make it easier for city elected officials, staff, and residents to better understand the net effect of the budget on taxpayers. Additionally, the City should summarize the taxes paid by Rockville residents to City and the County, as many residents are unaware of how their property taxes are allocated among governments.

Appendix: Working Group Members

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